

Assessing payment adequacy and updating payments: hospital inpatient and outpatient services

ISSUE: Do we believe that, effective fiscal year 2002, payments for all services hospitals provide to Medicare beneficiaries are adequate? What is the appropriate adjustment to account for efficient hospitals' cost increases next year? In the course of updating inpatient payments, should we close the gap in base payment rate between hospitals in large urban areas and those in other urban and rural areas?

KEY POINTS: Our estimate of the overall Medicare margin for hospital services in fiscal year 2002 is 3.8 percent, accounting for per unit cost increases and several other policy changes implemented between 1999 and 2003. Cost growth during the 1990s was unusually low, due primarily to large length of stay declines, but the cost increases since then have been larger. The higher growth appears justifiable, however, due primarily to added wage pressures. Thus, the hospital cost base nationally appears appropriate as of fiscal year 2002, and a 3.8 percent margin relative to those costs is within our range of adequacy. Other broad indicators (particularly trends in volume, provider entry and exit, and payments from private payers) are generally consistent with a conclusion of adequate payments.

If the Commission does conclude that current payments are adequate, then the appropriate allowance for the increase in efficient providers' costs next year for both inpatient and outpatient services would be CMS's forecast of the hospital market basket.

On the inpatient side, both margins data and cost analysis results suggest that the current system of two base payment rates (a 1.6 percent higher rate for hospitals in large urban areas) may be unwarranted. If the Commission elects to phase out this differential, the first step could be implemented through the payment update for fiscal year 2003 (that is, a smaller update for hospitals in large urban areas than for all other hospitals).

ACTION: At the meeting, staff will present draft recommendations addressing the differential in inpatient base rates, the inpatient update, and the outpatient update. The Commission needs to make policy decisions in all three of these areas, and also will have an opportunity to comment on the hospital section of the draft chapter on payment adequacy and updates for the March Report.

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